

Washington State Auditor's Office

Audit Report

Audit Services

Report No. 5717

DEPARTMENT OF NATURAL RESOURCES

Agency No. 490

Special Audit

August 17, 1993 Through April 17, 1996

Issue Date: December 13, 1996

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Background

On May 28, 1995, the Department of Natural Resources (DNR) notified the Office of State Auditor of a potential misappropriation of public funds. An employee reported that fictitious disbursement transactions had been made to a company owned by an environmental engineer in the Engineering Division. In coordination with our office, the DNR immediately began an investigation into the matter (Case No. 96-Z-QIX). We reviewed the work performed by the DNR and agree with the results of their investigation.

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Scope and Opinion

This report represents the results of our audit of certain transactions authorized by an environmental engineer at the Department of Natural Resources (DNR) during the period August 17, 1993, through April 17, 1996. The purpose of our audit was to determine if payments to an environmental testing company were made properly on behalf of the DNR.

Our audit was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. This audit was conducted under the authority of *Revised Code of Washington* (RCW) 43.09.330.

The scope of our audit was limited to determining whether certain payments to an environmental testing company were properly made and supported by testing reports and other appropriate documentation. The scope of our work was not sufficient to enable us to express an opinion on the agency's financial statements, and we do not express an opinion on the financial position or results of operations of the Department of Natural Resources

In our opinion, as detailed in the following finding, an environmental engineer misappropriated at least \$182,169.74 in public funds from the DNR.

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Schedule Of Findings

1. Public Funds Were Misappropriated By An Employee Of The Department Of Natural Resources

Our audit of the financial records of the Washington State Department of Natural Resources (DNR) revealed that at least \$182,169.74 in public funds was misappropriated by an employee of the Engineering Division during the period August 17, 1993, through April 17, 1996. There were no federal funds involved in this case. These funds were misappropriated as described below.

An environmental engineer processed fictitious disbursement transactions to his own environmental testing company. In July 1993, the engineer incorporated an environmental testing company and began awarding jobs and authorizing payments to this company for work which was allegedly performed. However, the DNR's investigation disclosed that none of the tests claimed were performed, and that none of the testing supplies paid for were received. Thus, the DNR received nothing of economic value for the payments made to this company.

The environmental engineer was completely responsible for selecting environmental testing and clean-up companies, monitoring the work performed by these companies, and authorizing contractual payments to these companies. As a result, he was able to circumvent agency policies and procedures when processing these fictitious transactions for his company. His employment with the DNR terminated on July 10, 1996.

RCW 42.20.060 states:

Falsely auditing and paying claims. Every public officer, or person holding or discharging the duties of any public office or place of trust under the state or in any county, town or city, a part of whose duty it is to audit, allow or pay, or take part in auditing, allowing or paying, claims or demands upon the state or such county, town or city, who shall knowingly audit, allow or pay, or, directly or indirectly, consent to or in any way connive at the auditing, allowance or payment of any claim or demand against the state or such county, town or city, which is false or fraudulent or contains any charge, item or claim which is false or fraudulent, shall be guilty of a gross misdemeanor.

The following internal control weaknesses allowed an employee of the Engineering Division to conceal these losses without being detected by agency management officials.

- a. There was an inadequate segregation of duties over the awarding, monitoring, and authorizing of payments to contractors. In addition, there was no periodic

management review of the work performed by this engineer which would accomplish the same objective as a segregation of duties between two or more employees.

- b. Management officials heavily relied on this environmental engineer as an expert and accepted his explanations for specific situations when any questions arose in the normal course of business operations.

We recommend the DNR seek recovery of the misappropriated \$182,169.74 and related audit investigation costs from the environmental engineer and their insurance bonding company. We further recommend the Washington State Office of the Attorney General and the Thurston County Prosecuting Attorney review this matter and take whatever action is deemed necessary. Any compromise or settlement of this claim must be approved in writing by the Attorney General and State Auditor as directed by RCW 43.09.330.

Bond coverage for agency employees is as follows:

Insurer:	National Union Insurance Company
Type of Policy:	Public Employee Blanket Dishonesty Bond
Amount:	\$5,000,000 (with \$100,000 deductible provision)
Policy No.	
and Period:	441-5055 August 1, 1993 to August 1, 1994
	443-4828 August 1, 1994 to August 1, 1995
	445-5447 August 1, 1995 to August 1, 1996

We also recommend the DNR review overall accounting controls over awarding, monitoring, and authorizing of payments to contractors, correct the weaknesses noted above, and implement an effective system of internal control designed to ensure the protection of public assets.

Auditee's Response

We agree with your recommendation that "DNR seek recovery of the misappropriated \$182,169.74 and related audit investigation costs from the environmental engineer and their insurance bonding company." We alerted the Thurston County Prosecutor's office early in our investigation and turned over all evidence gathered and continue working with them. The former employee has been charged and the criminal case is proceeding. We will seek recovery of the related audit investigation costs which total \$6,876.19 as of September 30, 1996, and related staff and testing costs (\$5,635.88) necessary to check the sites which the environmental company was supposed to have worked on. We've informed the Attorney General's office of this situation and will pursue additional avenues for recovery of the actual losses as well as investigation and follow-up costs.

We also agree with your second recommendation to "review overall accounting controls over awarding, monitoring, and authorizing of payments to contractors, correct the weaknesses noted above, and implement an effective system of internal control designed to ensure the protection of public assets." We implemented on May 16, 1996, the following measures to strengthen controls in the acquisition of environmental cleanup services.

1. *The Project Engineer will now be required to solicit a minimum of three vendors and document the process with a Record of Completion form (e.g., Form 7540-PUR-786).*

2. *The Division's Contracts Specialists will now do the following:*
 - (a) *Verify that three vendors were considered and that each of the vendors confirmed their quotations in writing. Vendors unable to comply will be considered unresponsive.*
 - (b) *Prior to letting a contract we will check the references of the successful vendor and check with state agencies (with certification authorities for the kind of work to be done) regarding the vendor's status.*
3. *The Facilities Manager or his representative (other than the Project Engineer that originated the transaction) will verify that the actual work was performed and documented before signing the field order to pay for the work.*